

California's Budget Conflict: *Lessons from the Present and the Past*



Daniel J.B. Mitchell
Ho-Su Wu Professor
Anderson & SPPSR
Feb. 17, 2004

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California's Budget Conflict:

Lessons from the Present and the Past

- **There is a BIG budget problem**
- **The conflict may not be where you think**
- **California's fiscal history provides some clues about the problem's location**
 - Taxpayer revolt
 - Transportation projects
 - Other public works & services
- **Implications**



Note: *A Work in Progress*



Comments and
suggestions welcome



John Vasconcellos

Dem. Senator - San Jose



*“I have never been so frightened
about California’s future as I am
now. The ingredients seem to be
here to take the state right over the
cliff.”*

Keith Richman Rep. Assemblyman - Northridge



*“Without bipartisan
cooperation, we are headed for
a fiscal train wreck.”*



Now Available

THE COMIC BOOK OF THE YEAR
ARMAGEDDON

*What's the
real story?*

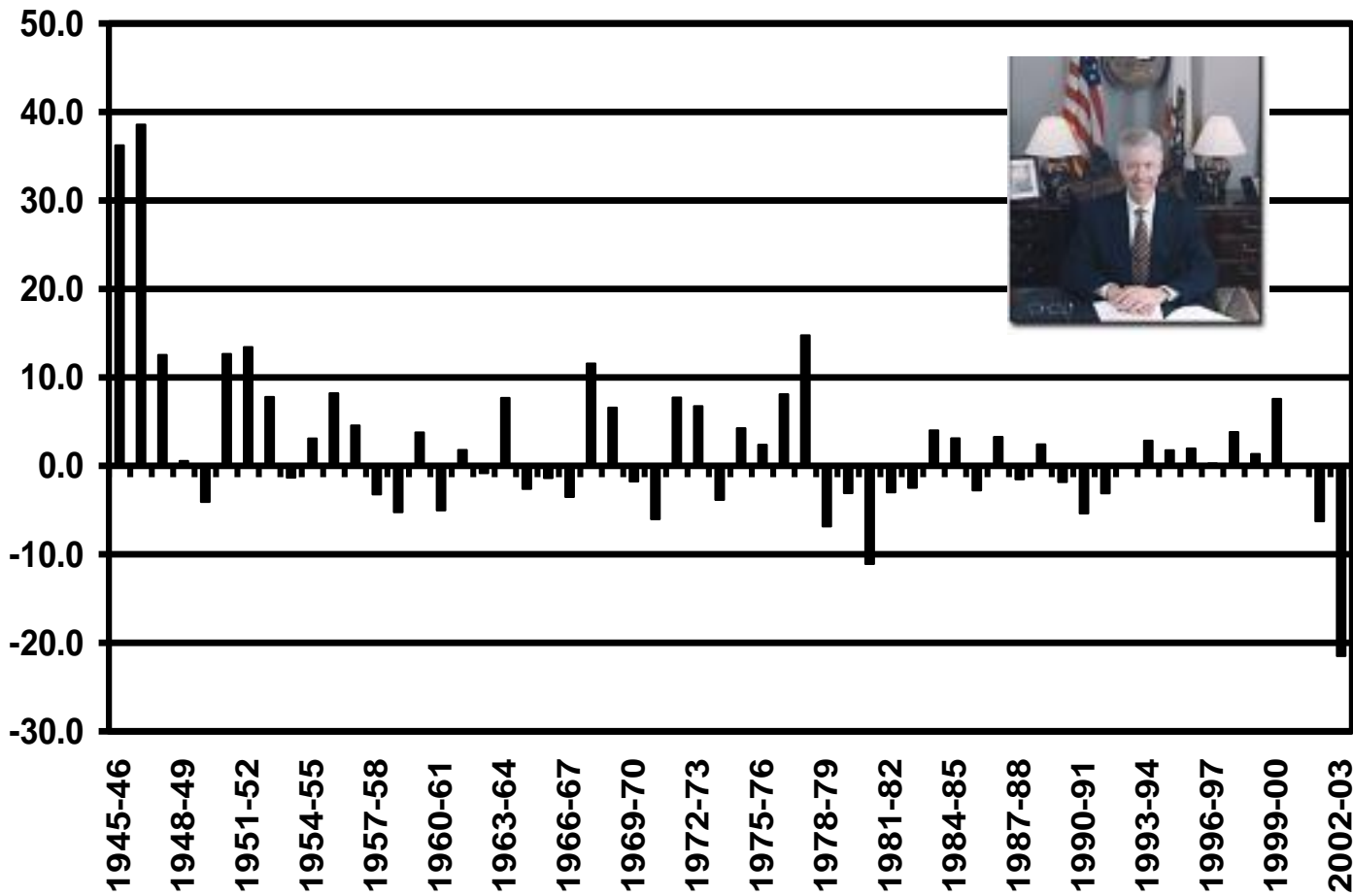


*Short run vs.
underlying*



General Fund Surplus or Deficit as Percent of Revenues & Transfers

CPObudget2004.xls
Surplus%

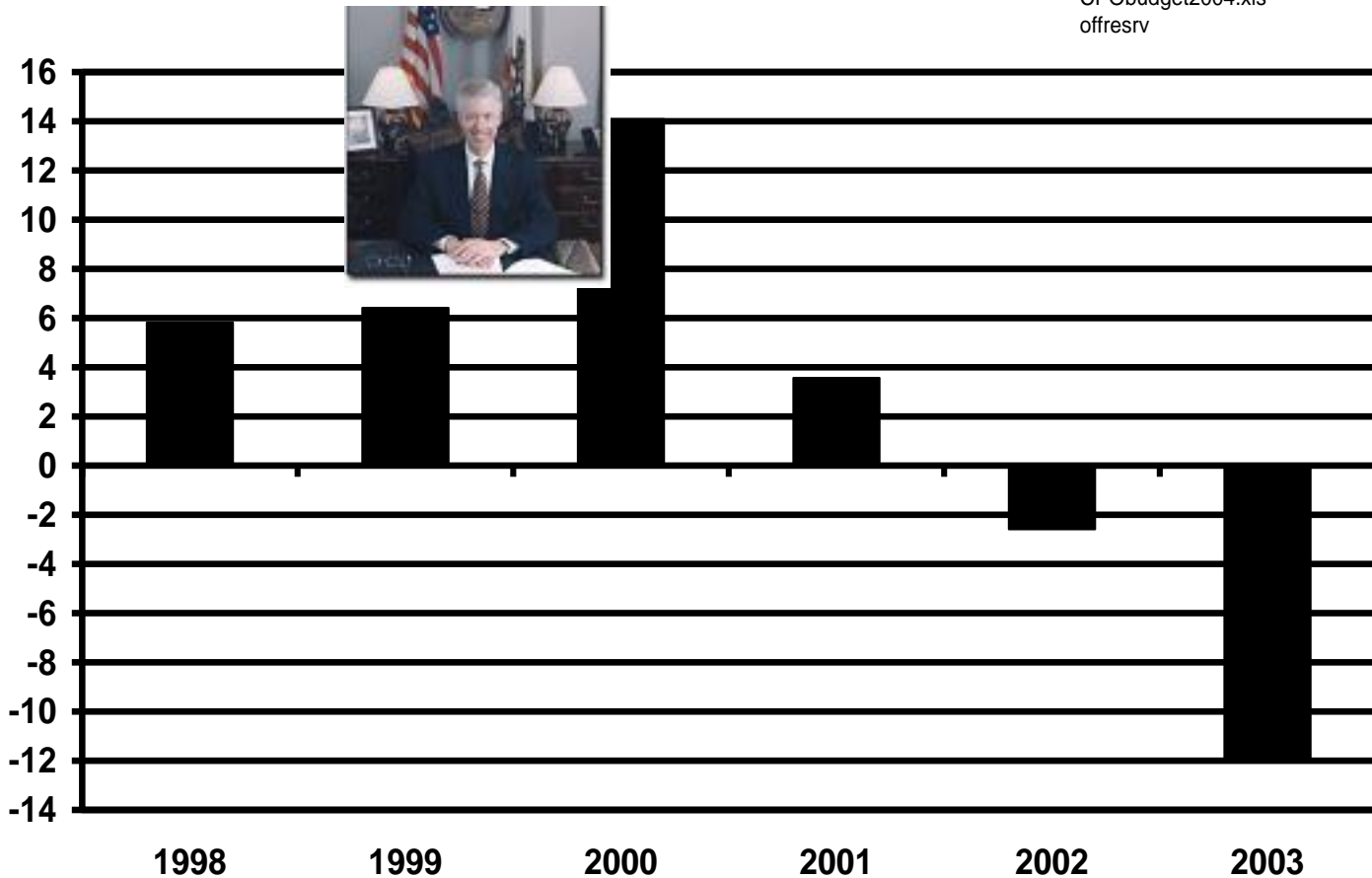


What happened?



Official Reserve as Percent of Expenditures: June 30 of Year Shown Excluding Proposed Deficit Finance for 2002-03

CPObudget2004.xls
offresrv



What happened?



Risks in the current budget



- New governor deficit financing bond may be rejected by voters
- Backup old governor deficit financing bond may be illegal
- RAWs mature in June 2004; high costs if must roll over
- Some revenues may not appear
- Planned cuts in payroll difficult to achieve

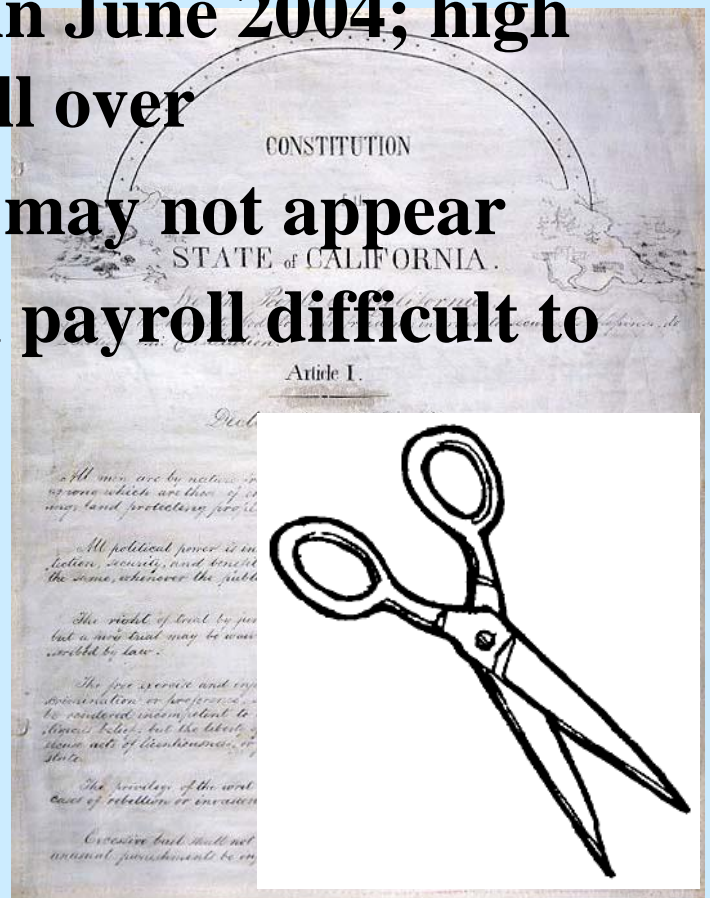
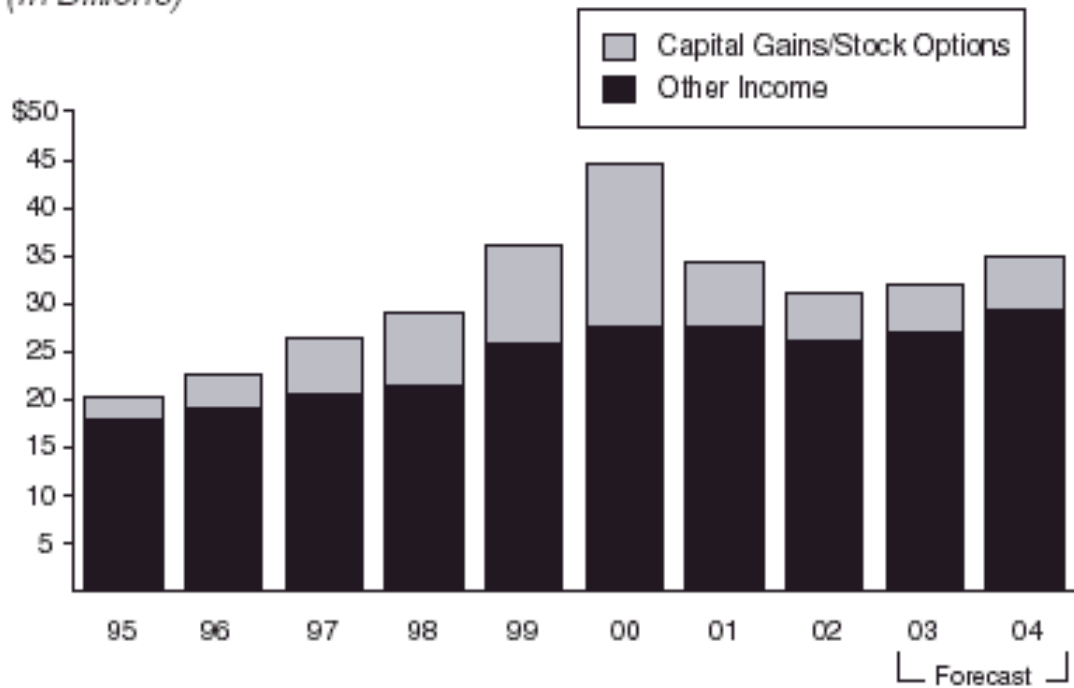


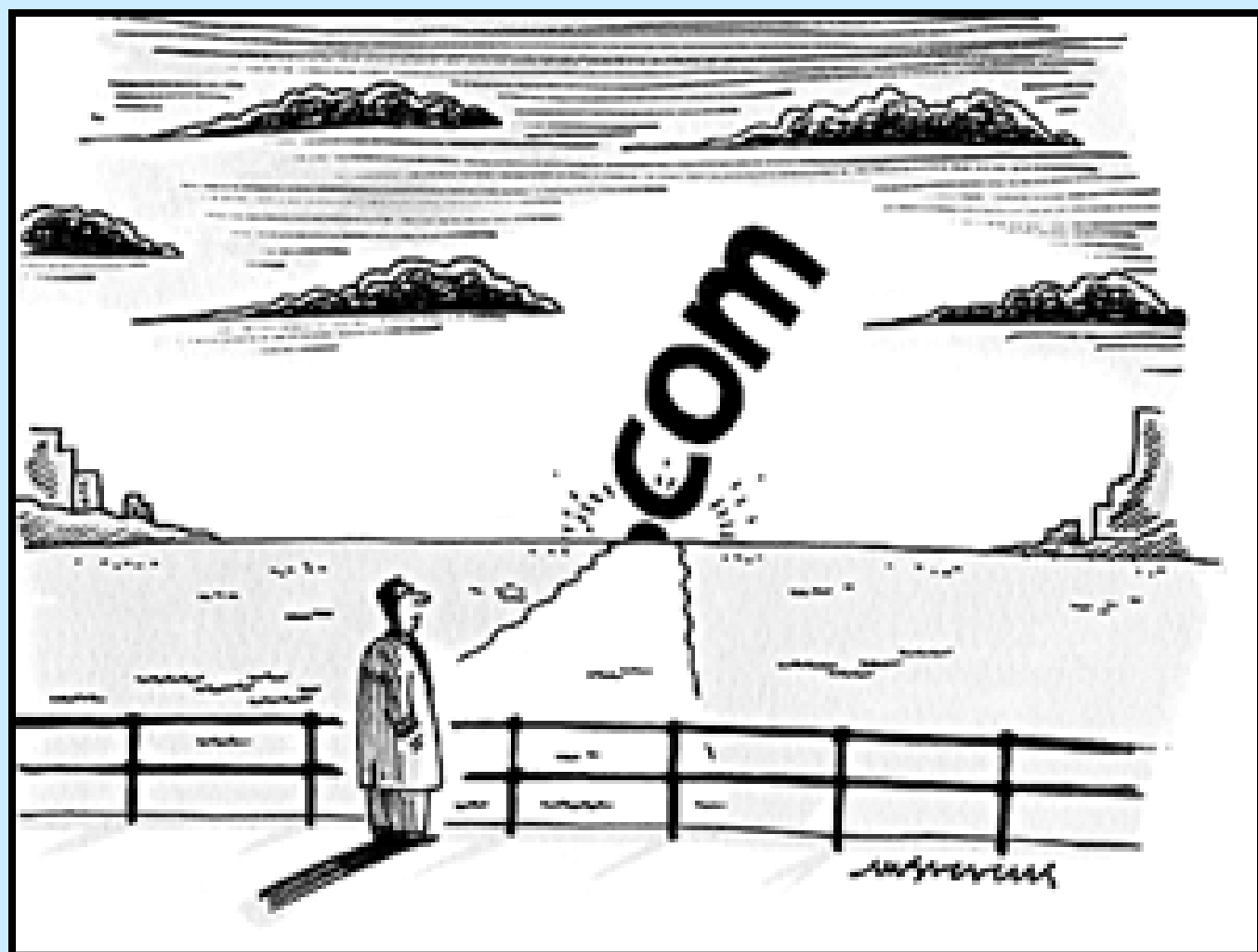
Figure 6

After Plunging, PIT Liabilities to Grow Moderately

*California Annual PIT Liabilities, by Source
(In Billions)*



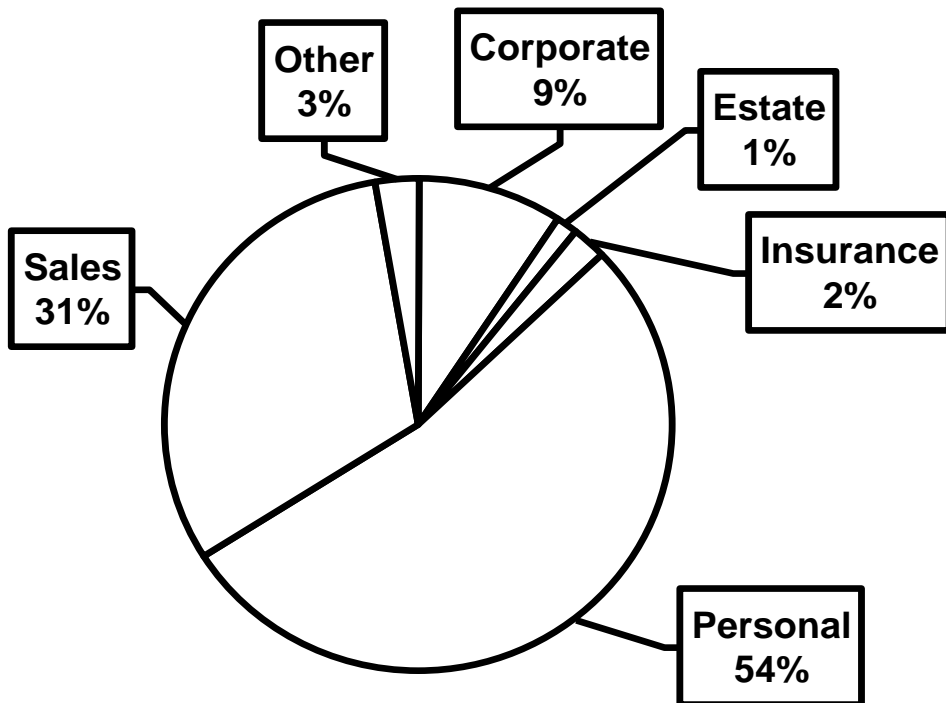
In FY 2000-01, personal income taxes produced \$17 billion in revenue from capital gains (22% of general fund revenue).



Budget Structure

General Fund Revenue Sources: 1997-98 - 2002-03

calborrow.xls
source%

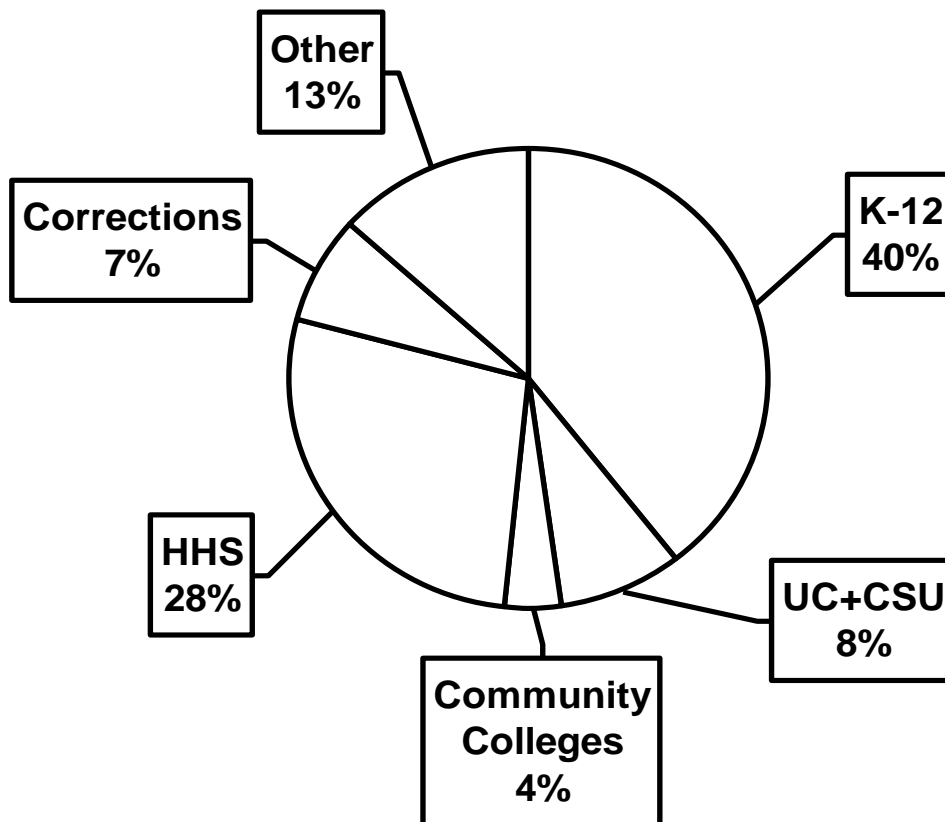


Note: Excludes tobacco bond revenue in 2002-03.

Budget Structure

General Fund Expenditure Categories: 1997-98 - 2002-03

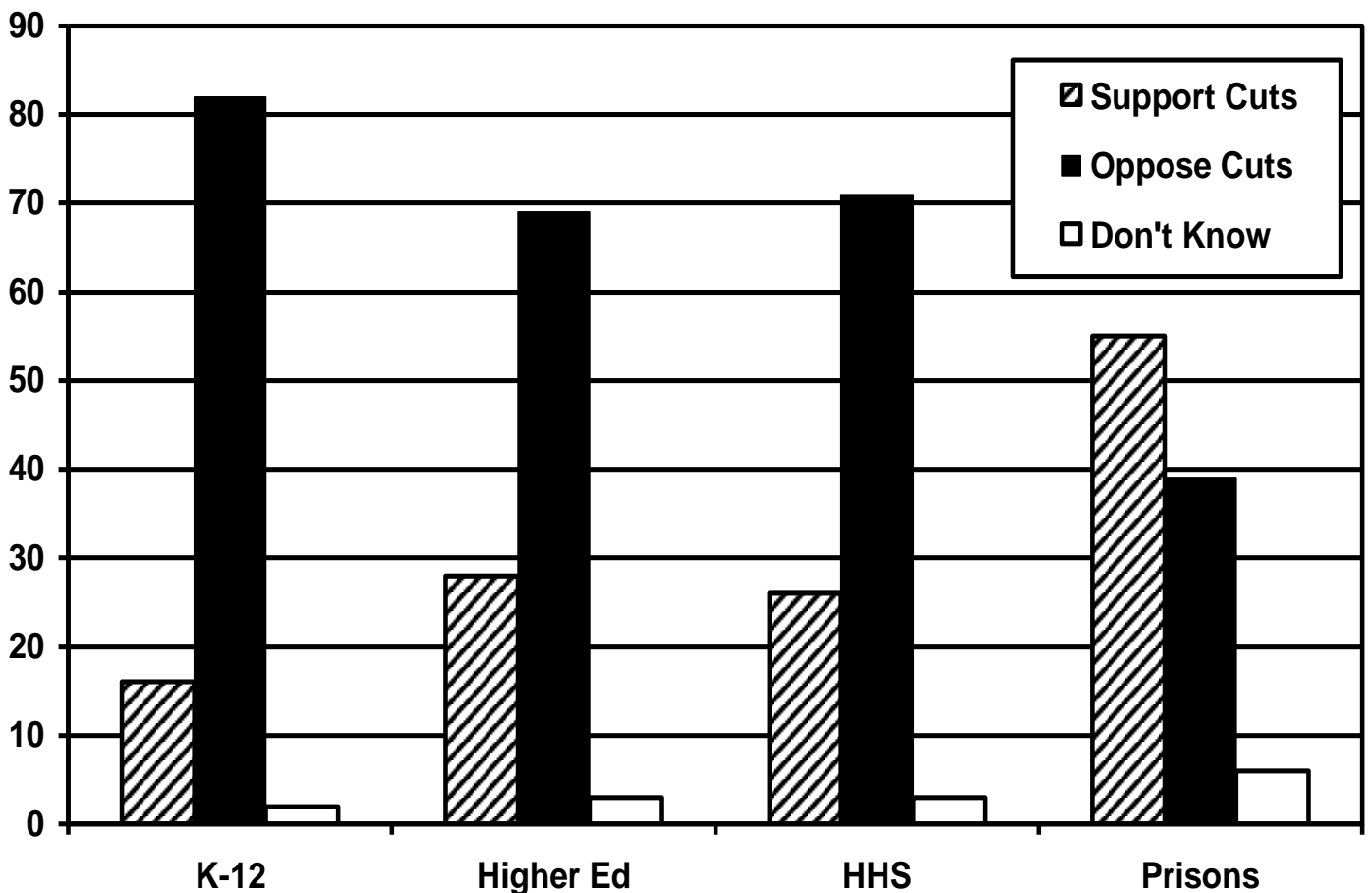
CPObudget2004.xls
spend%



Public Opinion (PPIC)

Opinions of Adult Californians Regarding
Possible Spending Cuts (Percent)

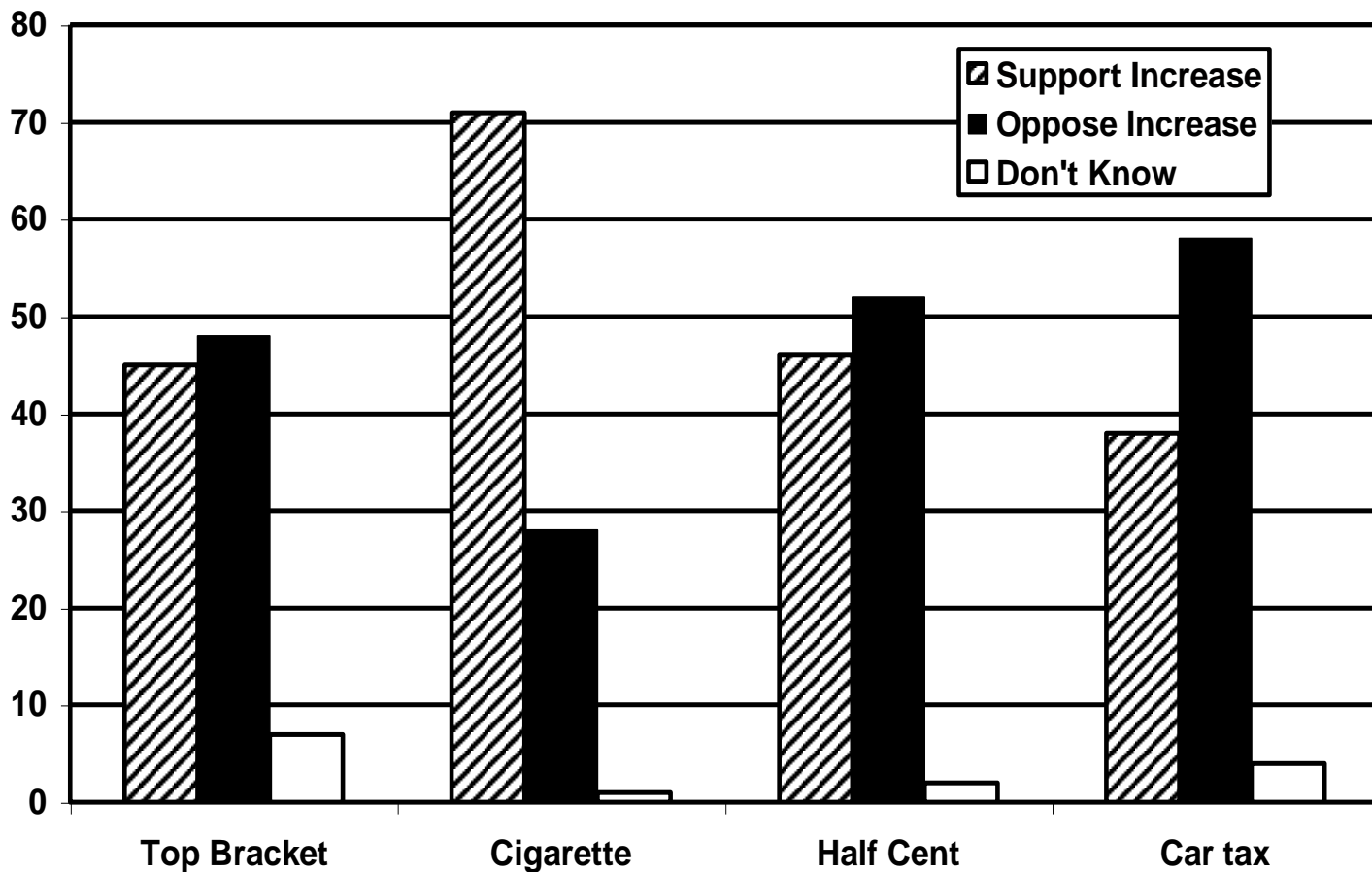
calopinion.xls
spendcut



Public Opinion (PPIC)

Opinions of Adult California Regarding
Potential Tax Increases (Percent)

calopinion.xls
taxup



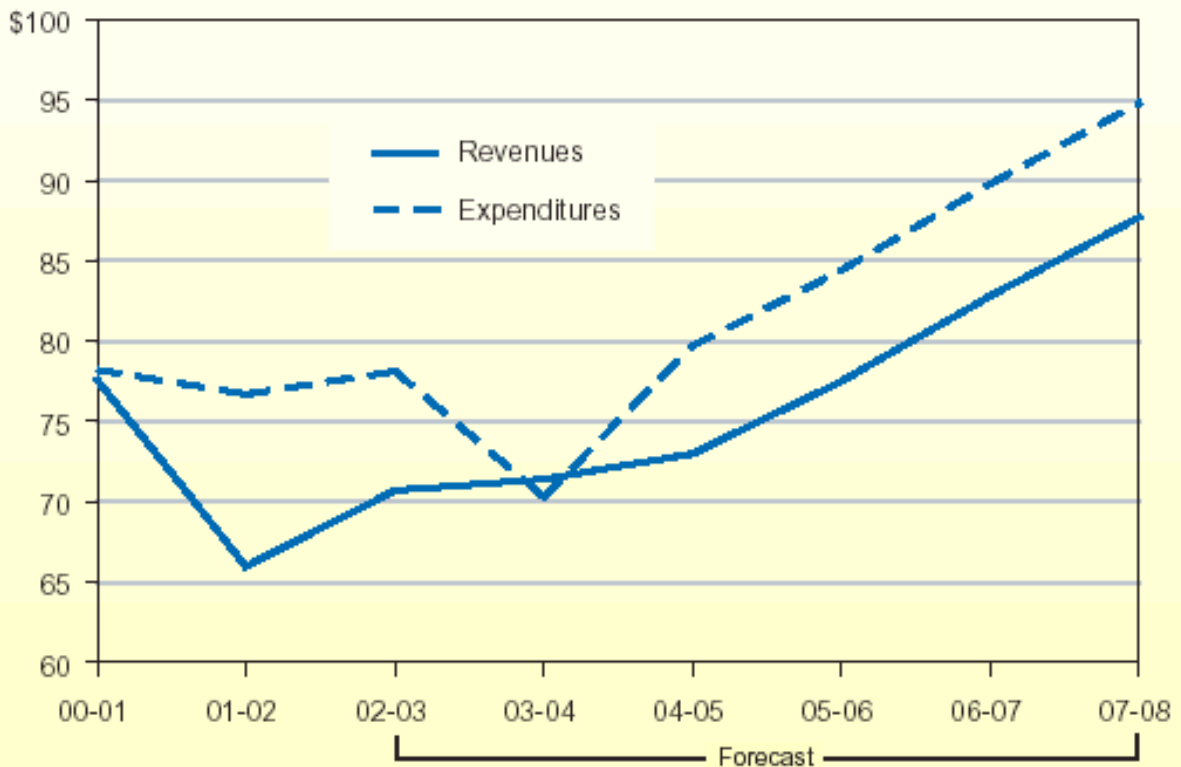
NOTE!

Structural Deficit Estimated by LAO under Davis

Figure 7

Persistent Gap Would Reemerge Under Governor's Plan

*General Fund
(In Billions)*



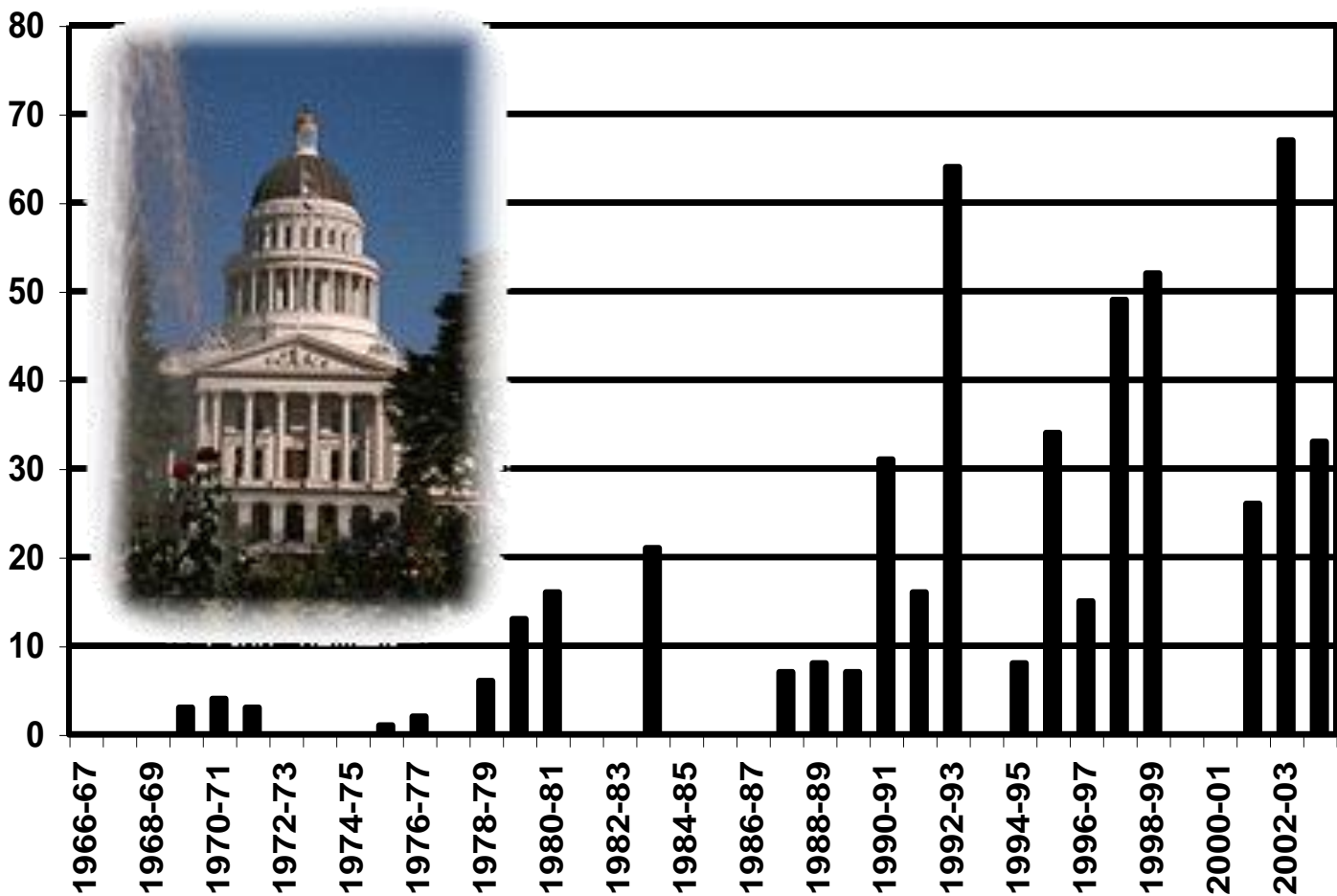
**Rand said same thing
in mid-1990s!**



Legislative Gridlock?

Days of Budget Delay Beyond June 30

CPObudget2004.xls
DELAY2



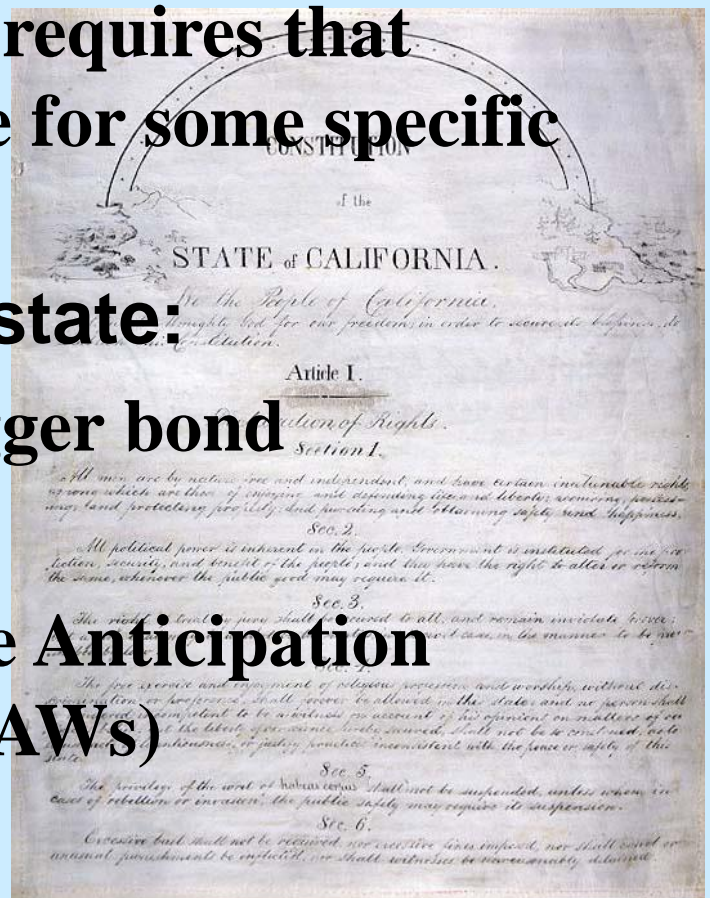
Groping for a Solution

RAVENS
© 1998 by the artist
All rights reserved.



temporary *Groping for a Solution*

- Deficit financing for another year plus refinancing of accumulated debt
 - Constitution requires vote on (long-term) obligations of general fund
 - Constitution requires that borrowing be for some specific purpose
- 3 Options for state:
 - Schwarzenegger bond
 - Davis bond
 - New Revenue Anticipation Warrants (RAWs)



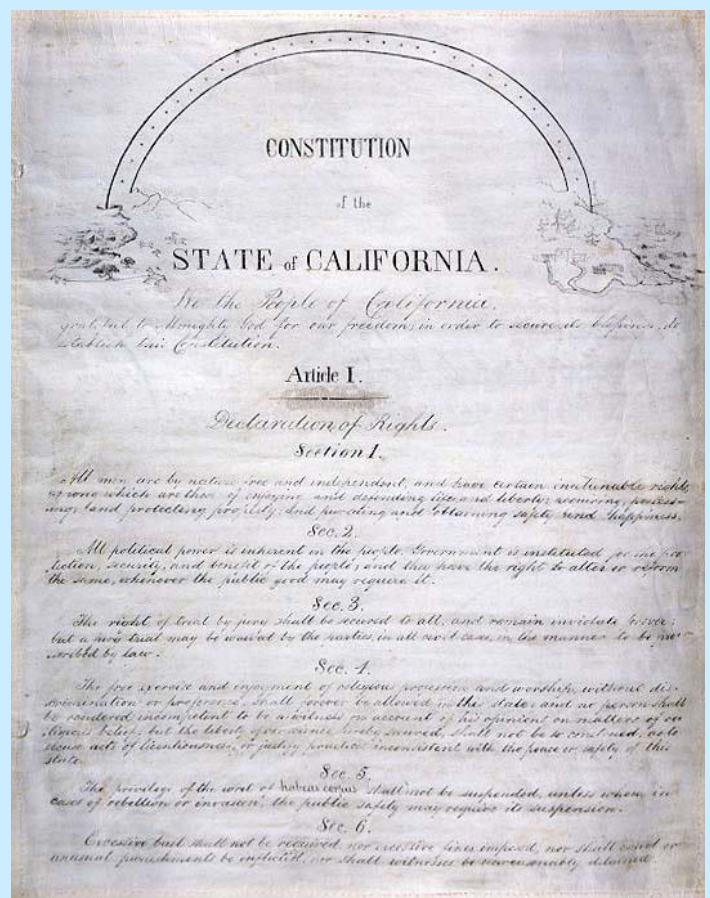
temporary *Groping for a Solution*

- **Option #1: Schwarzenegger \$15 billion bond on March 2004 ballot**
 - Ballot overcomes constitutional objection on need for vote
 - Companion “balanced budget” measure modifies constitution to overcome single purpose objection
 - Both measures must pass for bond to be floated
- **If bond fails to pass, move to Option #2**



temporary *Groping for a Solution*

- **Option #2: Davis \$10.7 billion bond**
 - Annual vote of Legislature required to pay debt service (to avoid having the bond be considered “long term”)
 - Complicated “triple flip” adopted by Legislature to make bond not an obligation of the general fund



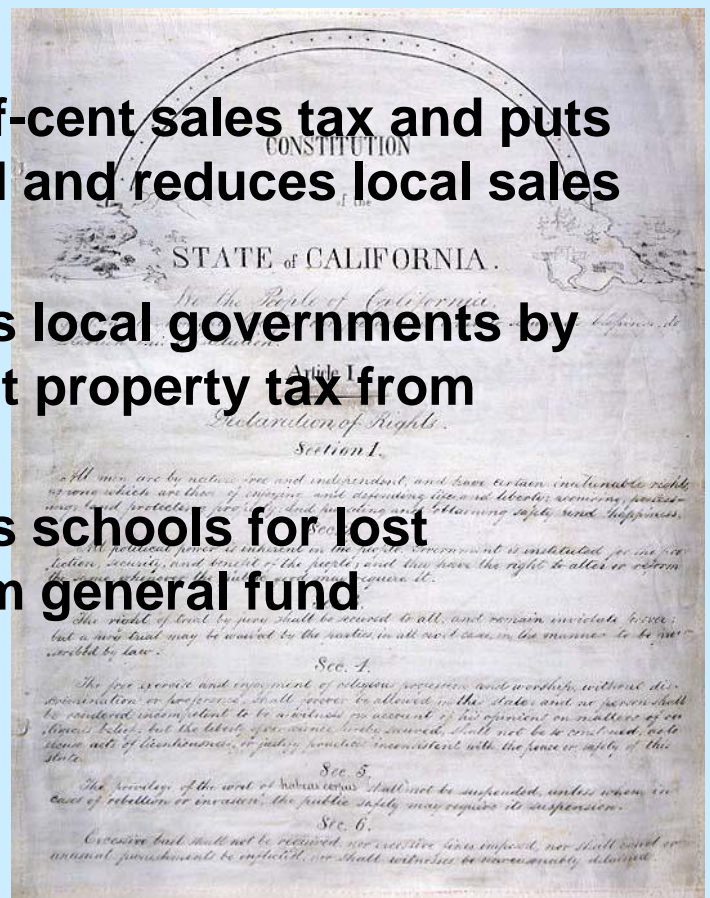
temporary *Groping for a Solution*



- **Options**
 - **Are**
 - to**
 - the**
 - **Can**
 - Le**
 - ob**



- **Triple flip:**
 - **State enacts half-cent sales tax and puts into special fund and reduces local sales tax by half cent**
 - **State reimburses local governments by taking equivalent property tax from schools**
 - **State reimburses schools for lost property tax from general fund**



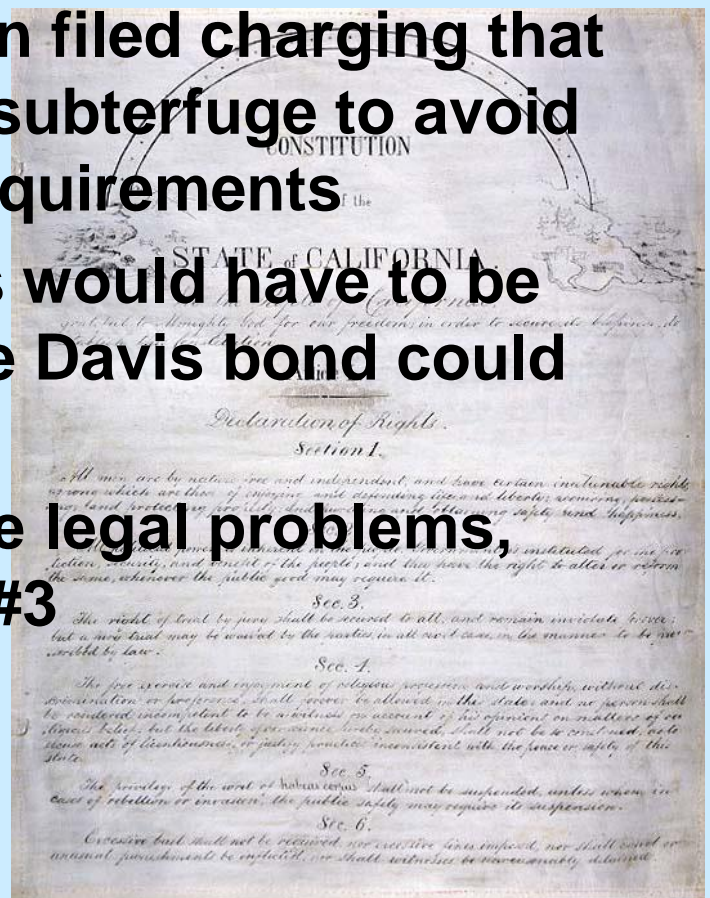
temporary *Groping for a Solution*



- **Options**
 - Are there any legal objections to the proposed solution (m’)
 - Can we overcome legal objections?

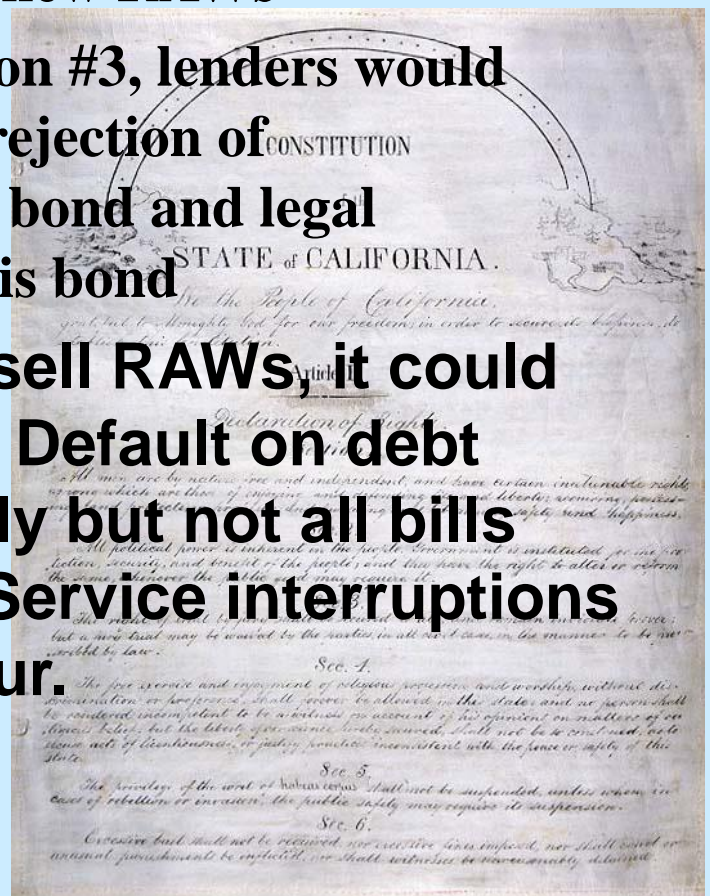


- Lawsuit has been filed charging that Davis bond is a subterfuge to avoid constitutional requirements
- Legal objections would have to be overcome before Davis bond could be sold
- If can't overcome legal problems, move to Option #3

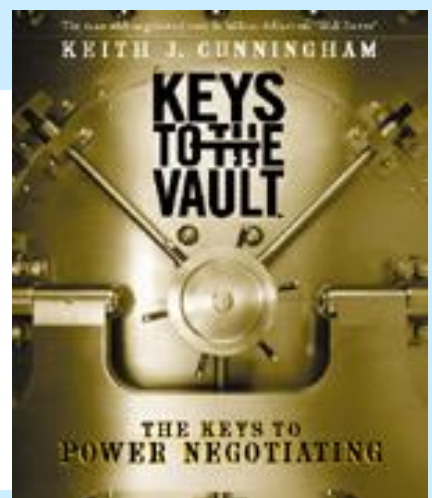
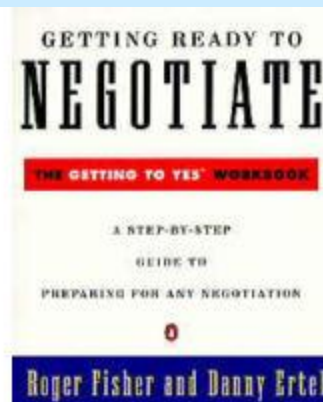
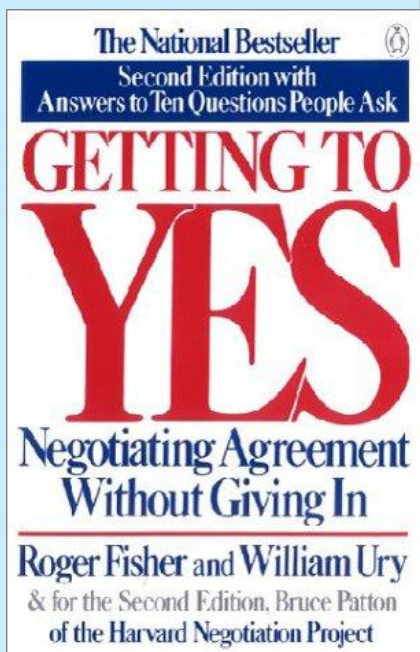
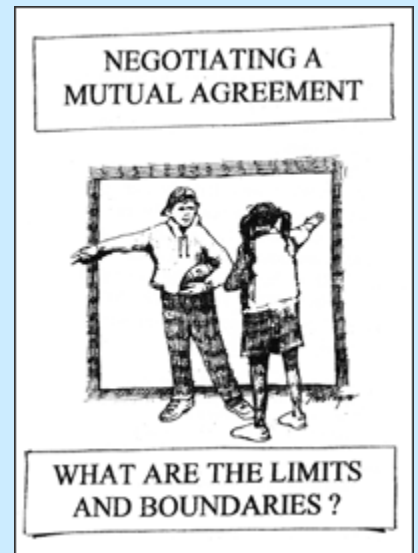
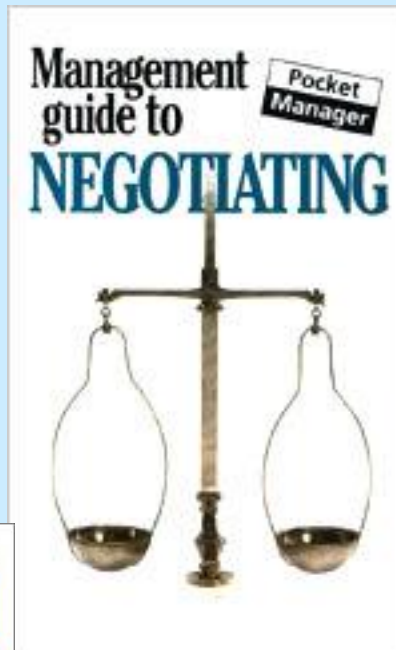
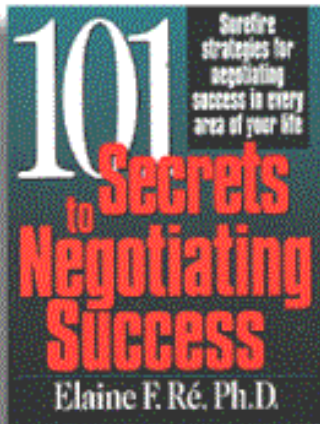


temporary *Groping for a Solution*

- **Option #3:
Revenue Anticipation Warrants**
 - State has \$11 billion in RAWs issued in June 2003 coming due + \$3 billion in Revenue Anticipation Notes (RANs)
 - Unless a budget is in place, potential lenders will not have a plan to examine for repaying the new RAWs
 - If we get to Option #3, lenders would have seen voter rejection of Schwarzenegger bond and legal challenge to Davis bond
- **If state failed to sell RAWs, it could run out of cash. Default on debt service is unlikely but not all bills would be paid. Service interruptions would likely occur.**



Generic Negotiation Approach?



Generic Negotiation Approach?



Management
guide to
NEGOTIATING

Pocket
Manager

NEGOTIATING A
MUTUAL AGREEMENT



ARE THE LIMITS
BOUNDARIES ?



The National Best
Second Edition
Answers to Ten Questions

**GETTING
YES**

**Negotiating Agreement
Without Giving In**

Roger Fisher and William Ury
& for the Second Edition, Bruce Patton
of the Harvard Negotiation Project

A STEP-BY-STEP
GUIDE TO
PREPARING FOR ANY NEGOTIATION

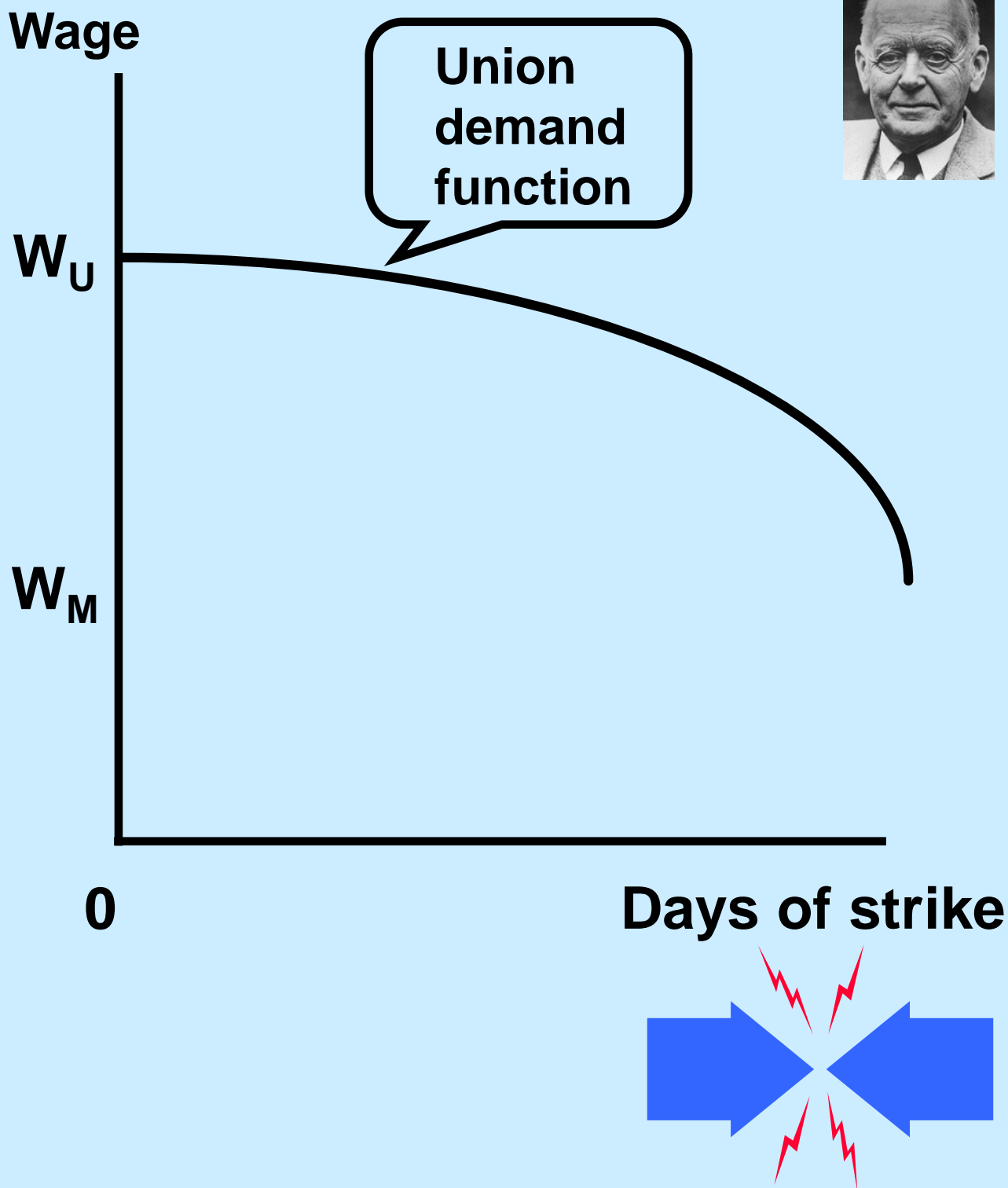
Roger Fisher and Danny Ertel



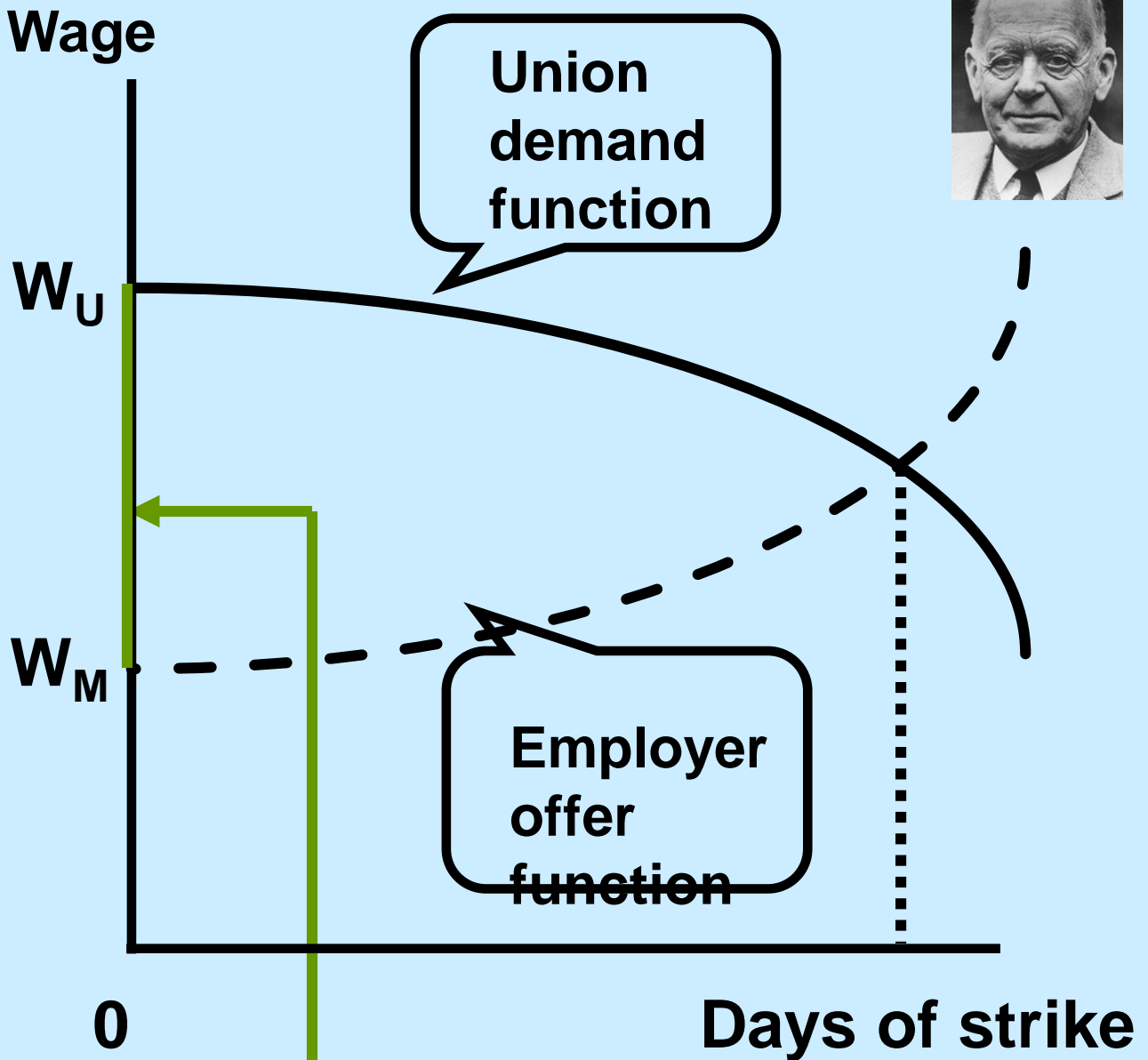
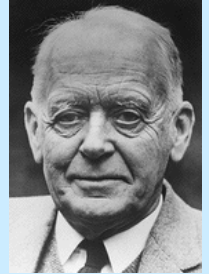
*Is the budget problem
another version of a labor
negotiation?*



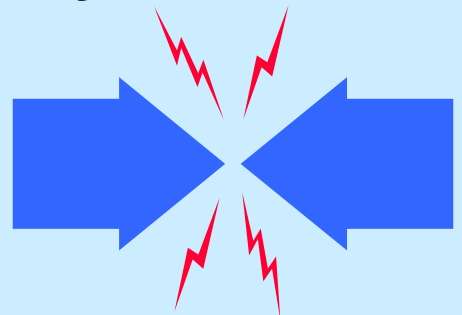
The Hicks Strike Model



The Hicks Strike Model



Why is there an impasse in the first place?



Who are the parties to the “negotiation”?

- **Legislature**
- **Governor**
- **Interest groups**
- **Electorate**



Who are the parties to the “negotiation”?

Why can't
we all just
get along?

Rodney King

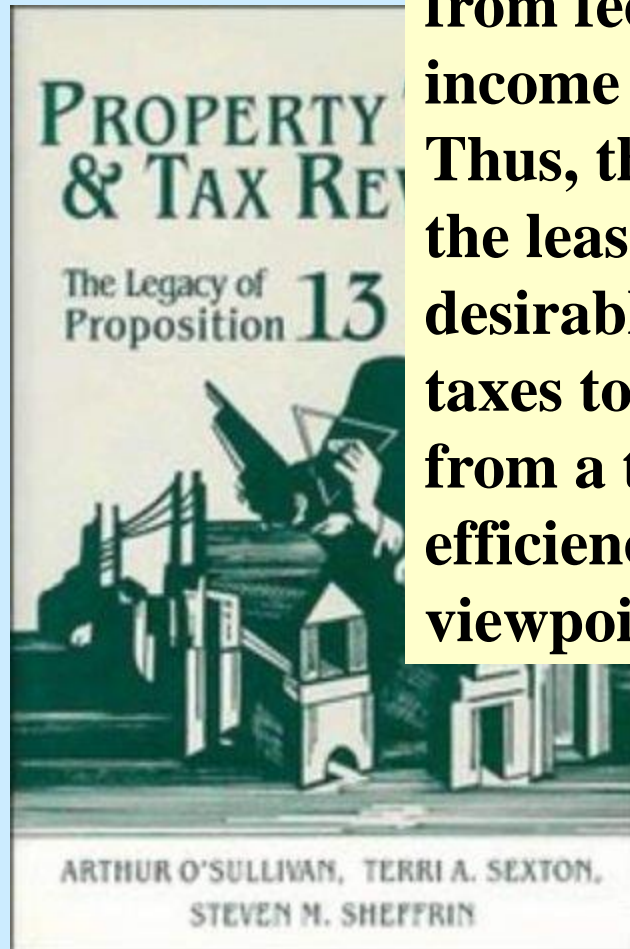


Howard Jarvis and Paul Gann celebrate



**Passage of Prop 13
(1978)**

Numerous Studies



Note that both property and car taxes are deductible from federal income tax. Thus, they are the least desirable taxes to cut from a tax efficiency viewpoint.

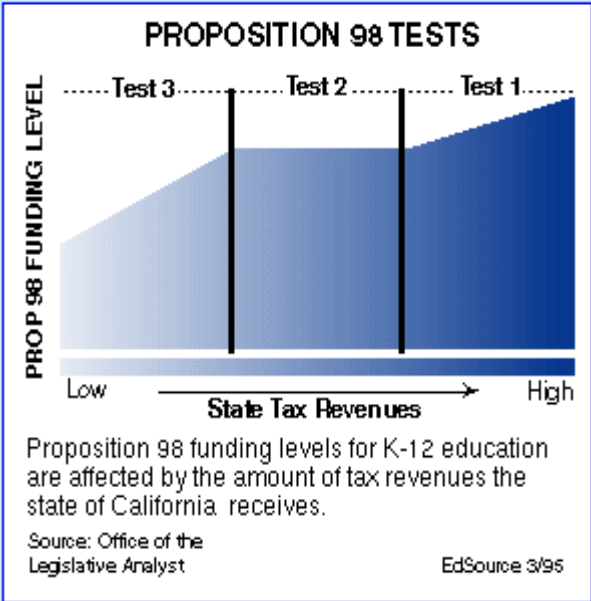
Question: Why was the *property tax* the focus of the taxpayer revolt?

Related Question: Why was the *car tax* such an issue in the recall?

Inadvertent consequence



**More dependence
on Sacramento ==>
more constraints
on Sacramento**



Inadvertent consequence



Fiscalization of land use



**BOTTOM LINE
QUESTION:**



***Why did we have a
taxpayer revolt?***

**BOTTOM LINE
QUESTION:**



***Why do we still have a
taxpayer revolt?***

Looking Outside the General Fund



- Governor's proposed expenditures from GF for 2004-05 = \$80.3 billion (excluding funny math)
- Governor's proposed expenditure from special funds = \$21.1 billion
- Lesson: About one fifth of expenditures (excluding pensions) is outside the GF



Transportation

- **Special funds to receive \$7.8 billion in motor-vehicle related taxes**
 - Fuel taxes
 - Registration, weight, license, etc.
- **Total expenditure for business-transportation-housing is to be \$5.5 billion (not all for transportation)**



Prof. Jeffrey Brown



Florida State University
PhD Urban Planning 2003

California State Archives



Sacramento

Gov. Olsen dedicates Arroyo Seco Parkway



...later known as the
Pasadena Freeway

Standard Federal Story

- **Constitution: Post roads**
- **Alternatives**
 - Rivers and canals
 - Railroads
- **Mainly local roads and local responsibility**
- **Good Roads movement**
- **Automobiles arrive**
- **Federal role expands with Bureau of Public Roads**



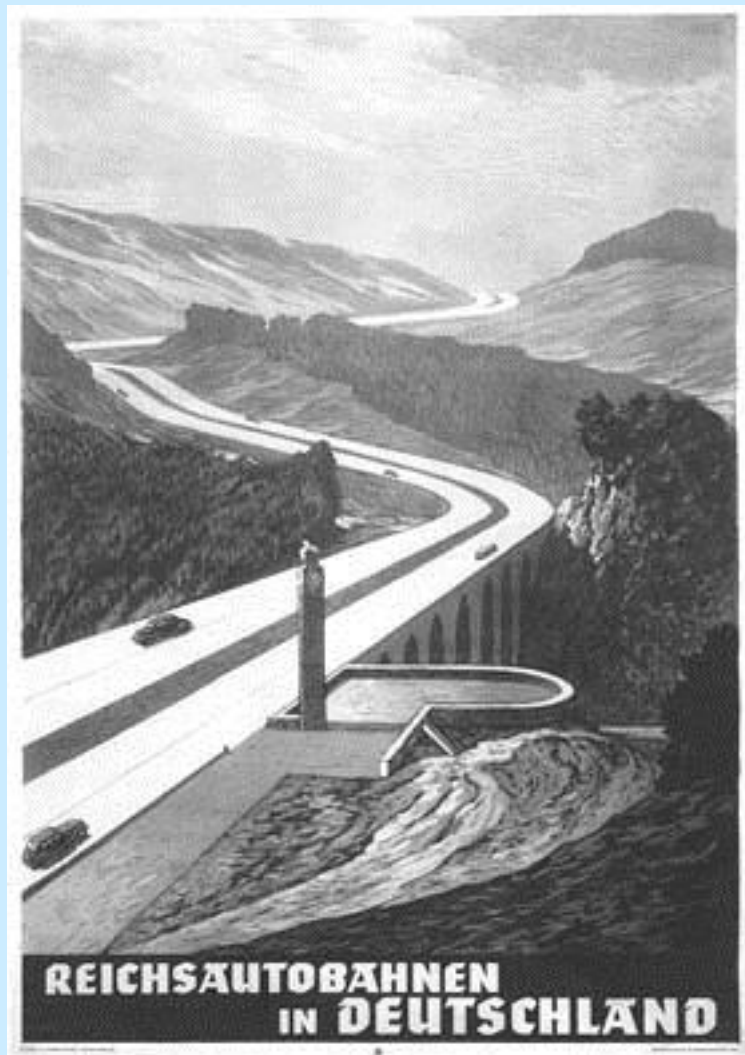
Standard Federal Story

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- **Mainly local roads and responsibility**
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- **Automobiles arrive**
- **Federal role expands with Bureau of Public Roads**
- **Depression gas tax & public works**
- **“Toll Roads and Free Roads”
report of 1939 (with funny math)**

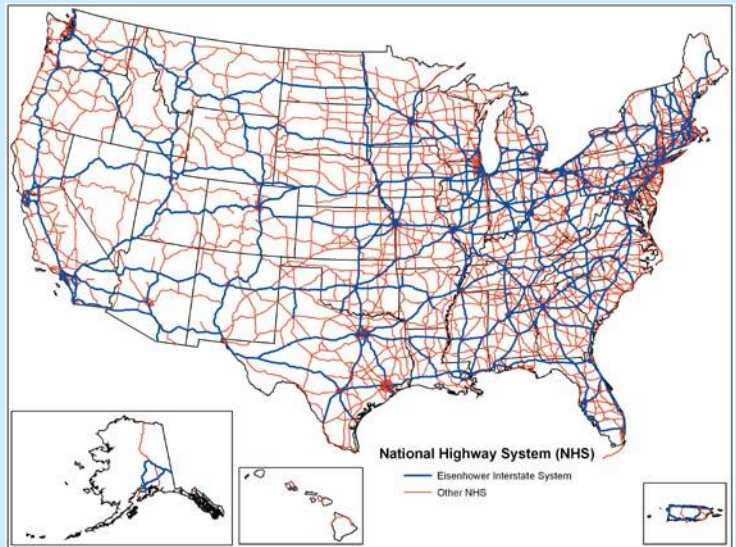


***“Germany ... made me see the wisdom
of broader ribbons across the land.”***

Dwight D. Eisenhower



1956: Federal Interstate and Defense Highway System Legislation



An interstate is born: The first was I-70 in Missouri and Kansas.



Federal-Aid Highway Act of 1956

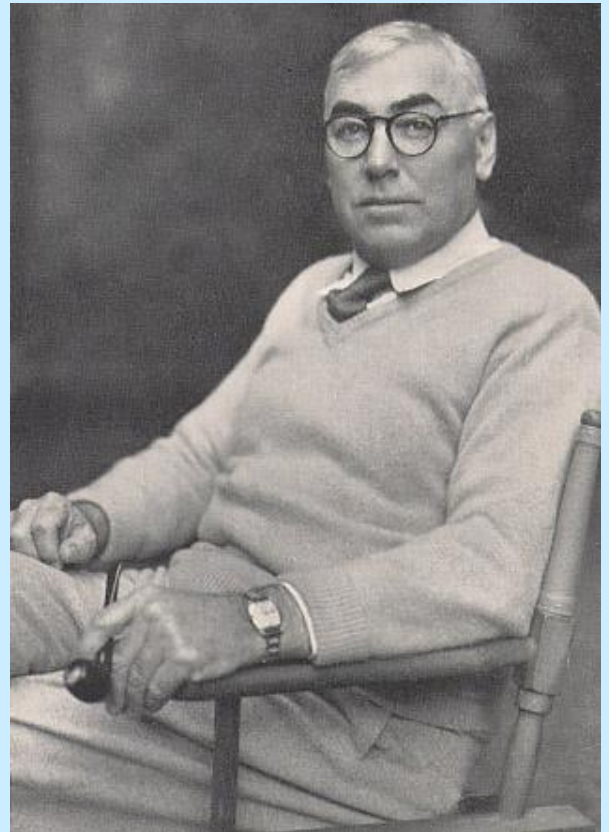
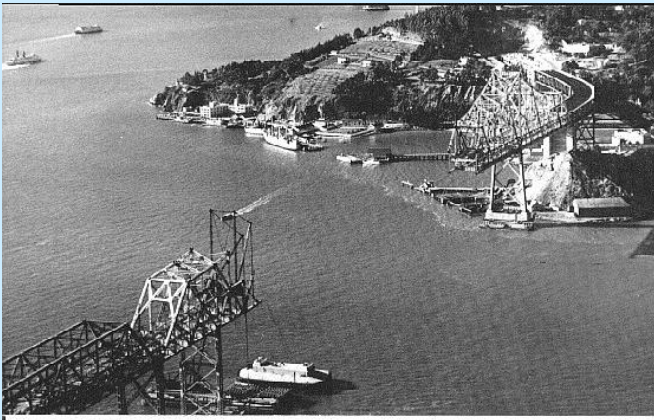
An Alternative California-centric Tale



Earl Warren



Charles H. Purcell



1940s Legislature

**“How are you today
Mr. Legislature?”**



Arthur H. Samish

***Collier's*, August 1949**

Building of Lakewood, California



**Annual rate of
growth:**

Calif.: 4.4%

U.S.: 1.4%

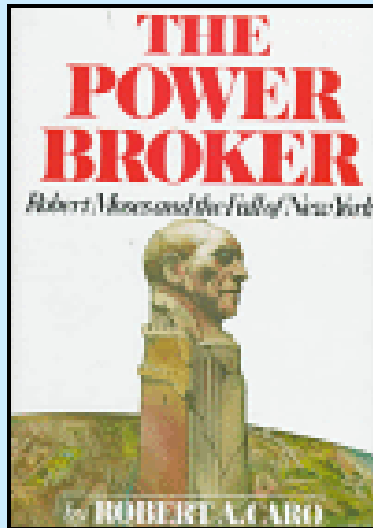
California Population in 1940:

7 million

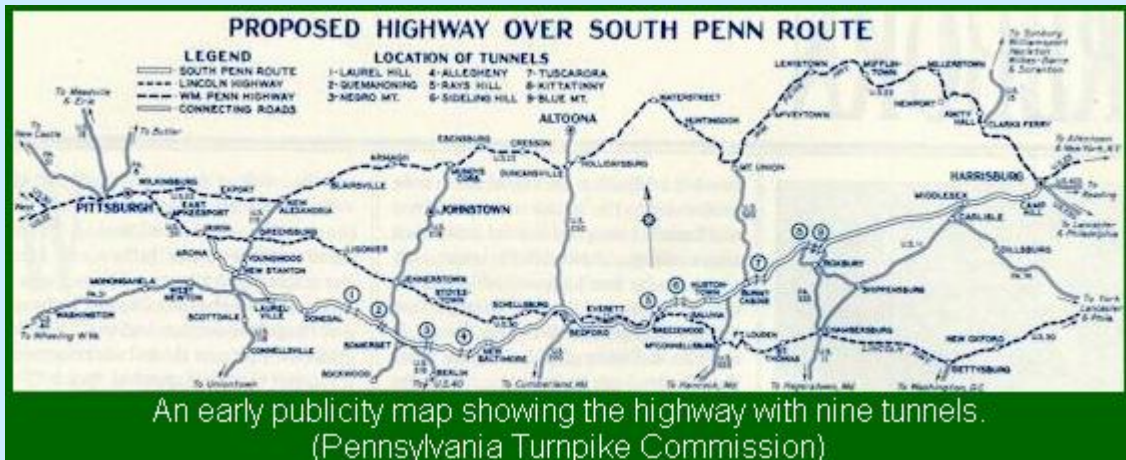
California Population in 1950:

10.6 million

Robert Moses and his NYC-area Parkways



Toll Roads?



Revenue Source: *Gas Tax*



Opposition from oil companies

Buses and Trucks



Ken Goudy Collection



Let cars pay for it.

Collier-Burns Act (1947)

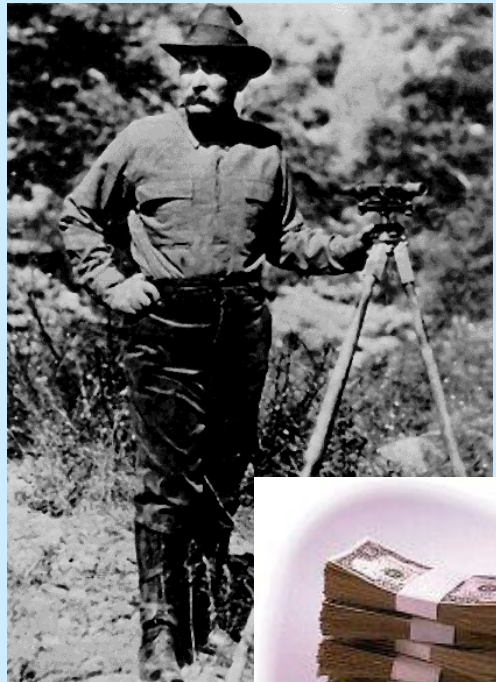
- **Proposal: Put gas and other motor-vehicle related taxes into trust fund to avoid “diversion”**
- **Raise gas and related taxes to build freeways and other roads**



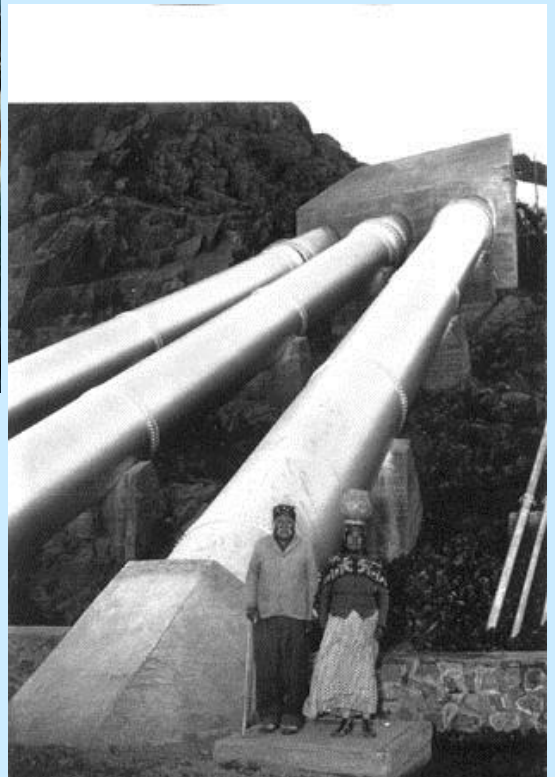
**Randolph Collier,
“Father of the American Freeways”
City of Yreka, CA
Dedicated 1995**



Owens Valley Project



Colorado Water Project



Master Plan for Higher Education





The California Deal

- **Vote bonds for water projects**
 - Get water paid for in water bills
- **Pay gas and related taxes**
 - Get roads and freeways
- **Pay state taxes**
 - Get higher education
- **Pay property tax**
 - Get schools, police, fire





The California Deal

- **Property taxes rise rapidly in 1970s due to rising real estate values**
 - Did schools, police, fire service improve proportionately?
 - Busing controversy in LA especially SF Valley weakens link between school and property tax payer
- **Car tax increase in 2003**
 - Were new roads, etc., going to result?



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Lesson #1

The conflict is with the electorate. Thus, negotiations models are not relevant. The state can't negotiate with the electorate.

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Lesson #2

Voters want the old California deal. Fiddling with term limits, etc., will not resolve the conflict.

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Lesson #3

**Need closer tie between taxes
paid and services delivered.
That implies user fees, move of
revenue and expenditure back
toward local govt.**

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Lesson #4

**Since deal was breached, need
devices to renew trust. Trust
funds, performance targets,
perceived accountability,
honest budgets.**

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